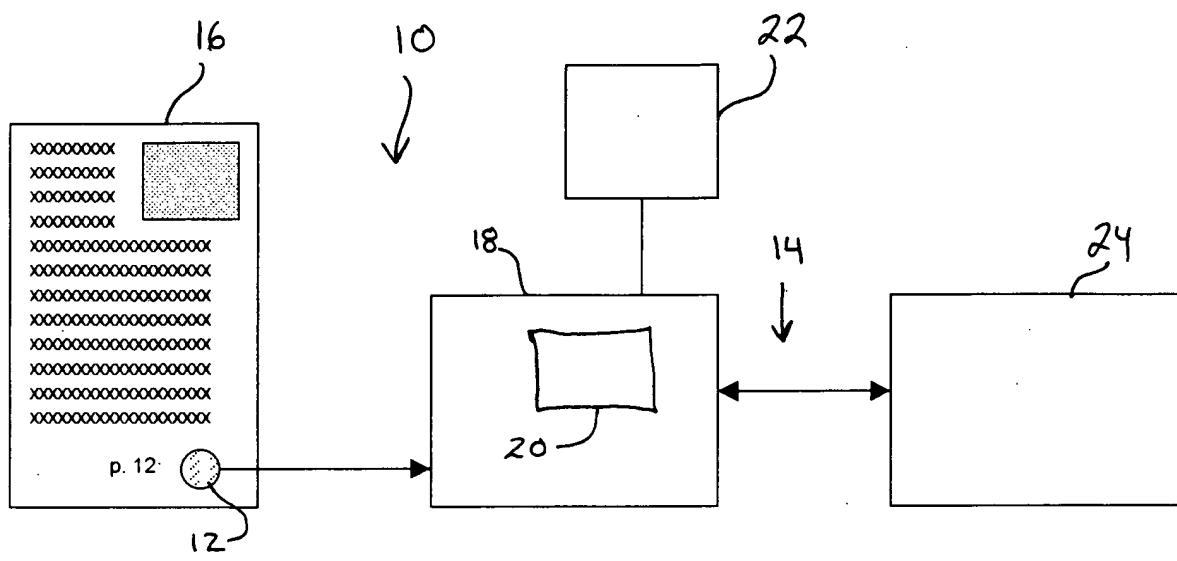


Figure 1



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25.2 WHY LEASE?

You hear many suggestions about why companies should lease equipment rather than buy it. Let us look at some sensible reasons and then at four more dubious ones.

Sensible Reasons for Leasing

Short-Term Leases Are Convenient Suppose you want the use of a car for a week. You could buy one and sell it seven days later, but that would be silly. Quite apart from the fact that registering ownership is a nuisance, you would spend some time selecting a car, negotiating purchase, and arranging insurance. Then at the end of the week you would negotiate resale and cancel the registration and insurance. When you need a car only for a short time, it clearly makes sense to rent it. You save the trouble of registering ownership, and you know the effective cost. In the same way, it pays a company to lease equipment that it needs for only a year or two. Of course, this kind of lease is always an operating lease.

Sometimes the cost of short-term rentals may seem prohibitively high, or you may find it difficult to rent at any price. This can happen for equipment that is easily damaged by careless use. The owner knows that short-term users are unlikely to take the same care they would with their own equipment. When the danger of abuse becomes too high, short-term rental markets do not survive. Thus, it is easy enough to buy a Lamborghini Diablo, provided your pockets are deep enough, but nearly impossible to rent one.

Cancellation Options Are Valuable Some leases that *appear* expensive really are fairly priced once the option to cancel is recognized. We return to this point in the next section.

Maintenance Is Provided Under a full-service lease, the user receives maintenance and other services. Many lessors are well equipped to provide efficient maintenance. However, bear in mind that these benefits will be reflected in higher lease payments.

Standardization Leads to Low Administrative and Transaction Costs Suppose that you operate a leasing company which specializes in financial leases for trucks. You are effectively lending money to a large number of firms (the lessees) which may differ considerably in size and risk. But, because the underlying asset is in each case the same saleable item (a truck), you can safely "lend" the money (lease the truck) without conducting a detailed analysis of each firm's business. You can also use a simple, standard lease contract. This standardization makes it possible to "lend" small sums of money without incurring large investigative, administrative, or legal costs.

For these reasons leasing is often a relatively cheap source of cash for the small company. It offers financing on a flexible, piecemeal basis, with lower transaction costs than in a private placement or a public bond or stock issue.

Tax Shields Can Be Used The lessor owns the leased asset and deducts its depreciation from taxable income. If the lessor can make better use of depreciation

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FIG. 3

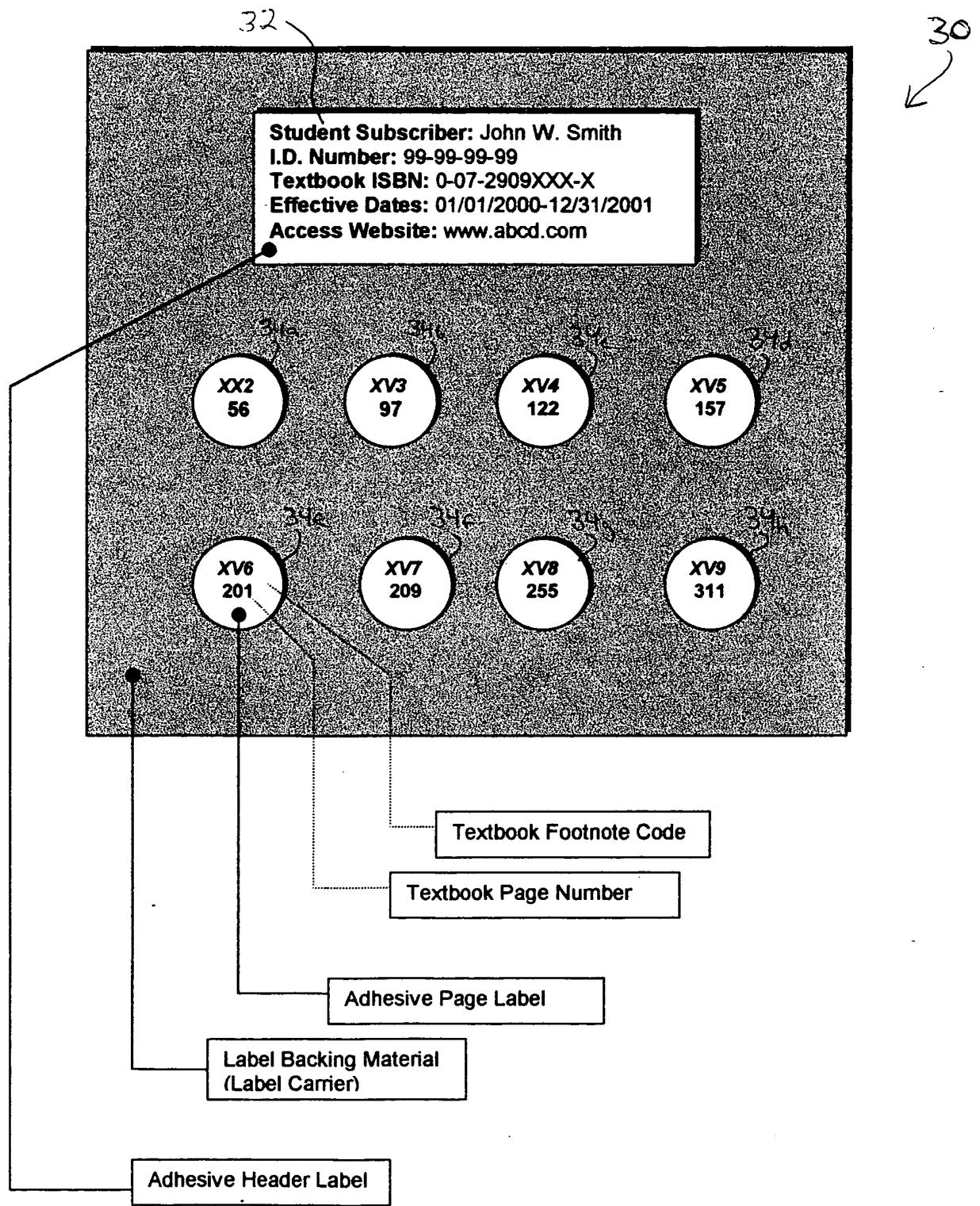


FIG. 4

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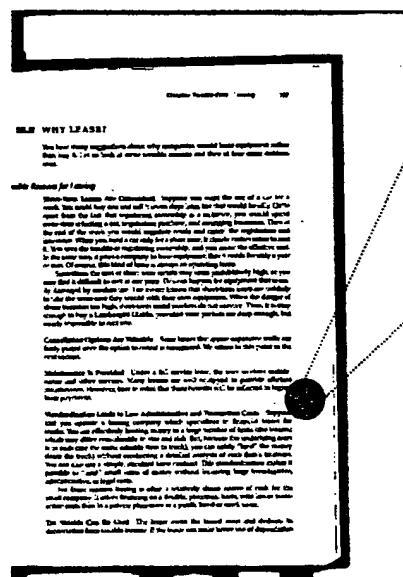
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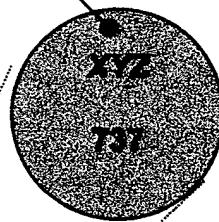
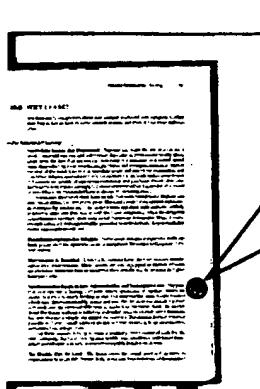
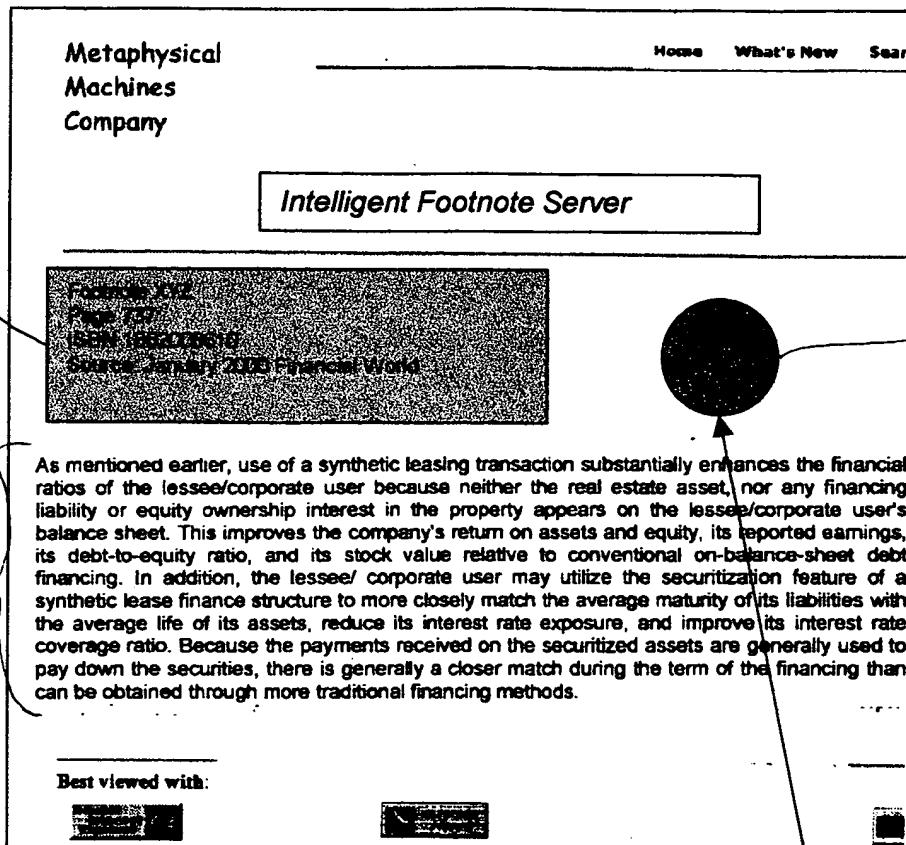


FIG. 5

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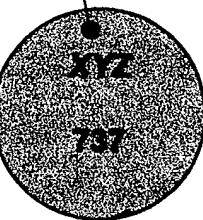


FIG. 6

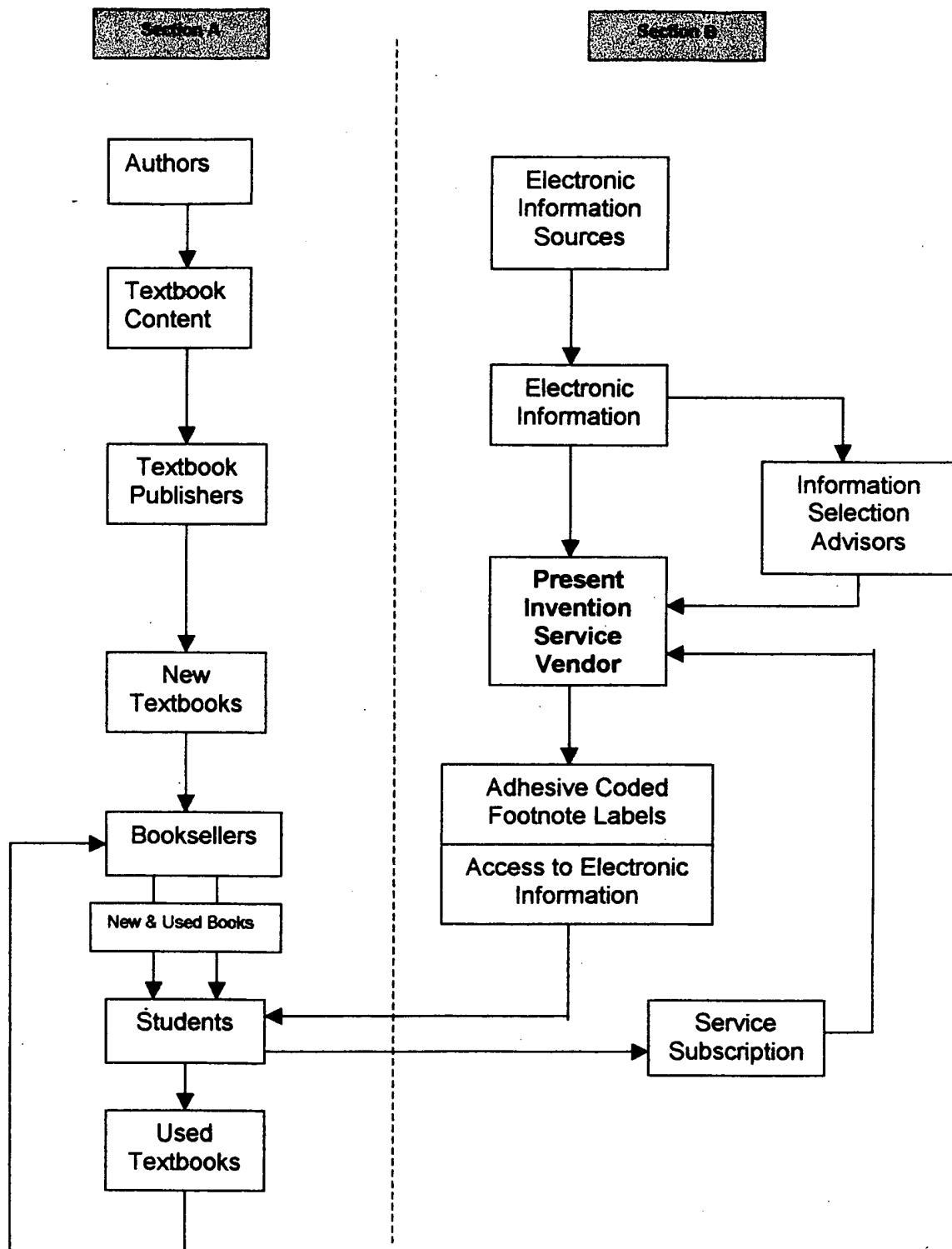


FIG. 7

